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European Unemployment and Economic Trends: 1985-89

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EUROPEAN UNEMPLOYMENT AND ECONOMIC TRENDS; 1985-89

AN INTERNSHIP REPORT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF SCIENCE IN SOCIAL AND APPLIED ECONOMICS

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I HEREBY RECOMMEND THAT THE INTERNSHIP REPORT PREPARED UNDER MY SUPERVISION BY **Ramez M. Fihani**

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ABSTRACT

This report analyzes the macroeconomic conditions for 15 OECD European countries for the second half of the 1980's. The study methodology begins by comparing Europe's aggregate economic performance against that of the United States and Japan for the 1985-89 period. A concentrated effort is made to analyze and explain the factors causing the comparatively high European unemployment rates. The report also reviews various political and economic sources to document the recent trends of 1985, 1986, and three quarters of 1987 for each of the following 15 European countries: Austria, Belgium, Denmark, Finland, France, West Germany, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and United Kingdom (U.K.). It then extrapolates the 1988 major occurrences and macroeconomic movements.

The report concludes that European economic growth has kept pace with growth in the United States and Japan in the 1980's. However, behavior in the unemployment pattern in Europe has been different for post-1986 than it was prior to 1986. In the post-1986 period, the unemployment in Europe has been declining in a way that is consistent with the macroeconomic theory, while prior to 1986, the European unemployment had been rising. Macroeconomic explanations were inadequate to account for the pre-1986 pattern.

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PREFACE

This project was prepared for my former manager to assist him during his annual trip to the European marketing organizations, which are subsidiaries of a U.S. multinational corporation operating in the 15 European countries. The purpose of his trip was to review respective financial plans for the upcoming year (1988). The plans prepared by the European marketing subsidiaries were based on certain assumptions related to the general expectations of the macroeconomic movements of the respective countries. Therefore, the challenge of this report was to assist the manager in assuring that the assumptions made at the country level were realistic, and consistent with those made at the International Group level of the corporation (Europe Group).

Europe has been experiencing high growth rates in output accompanied by high unemployment. As illustrated in this report, France is a prime example where GDP growth has been increasing consistently while the employment rate has been decreasing. The macroeconomic literature has not been satisfactory in explaining the phenomenon of high European unemployment, mainly because each theory only explained one aspect of Europe's high unemployment problem in the 1980's.

This report contributes to the discussion by offering a multi-causal explanation of the European unemployment problem. The alternative explanation is based upon assumptions of labor productivity, population growth, and

institutional rigidities. The report concludes that toward the latter part of the 1980's, the trend in Europe's GDP growth and unemployment returned to their normal patterns. Overall, the European unemployment is on a declining trend accompanied by growth in GDP and a declining wage rate. The declining wage and unemployment rates have significant implications for U.S. multinational corporations operating in Europe because:

1) A smaller unemployment level translates into a larger purchasing base and therefore increased corporate revenues.
2) As unemployment is reduced along with the wage rate (i.e., as wage rigidities in the European markets are eliminated) total labor costs are reduced. This will have a direct positive impact on the corporate bottom line - profitability.

U.S. Multinational Corporations must be well aware of the recent developments taking place in Europe (e.g., the German unification and Europe 1992). An analysis of these factors goes beyond the scope of this report, but are nonetheless discussed briefly in the last section. U.S. multinational corporations must position themselves in the European markets through mergers and acquisitions to be able to successfully compete in the 1990's.

The requirements of this report were such that it had to be comprehensive and in a summary format so that it could be used as a quick guide during the annual review meetings at each country marketing organization. The study format reflects this requirement.

This study represents an internship report conducted in the fourth quarter of 1987 is a partial fulfillment of the requirements for the degree of Master of Science in Social and Applied Economics.

I. Introduction

In trying to understand the major macroeconomic trends for the fifteen OECD European countries, this report first compares the aggregate European market performance against the United States and Japan **(Section II)**. The major economic indicators reviewed are: the major monetary developments in the 1980's, the growth in the Gross Domestic Product (GDP), unemployment, inflation, productivity, and wages for the 1985-89 period.

In view of the comparative analysis, it was determined that while European growth was competitive with the United States and Japan, the European unemployment rate was significantly higher than in the United States and Japan. **Section III** reviews the literature and offers different explanations that have caused the European unemployment rate to be high in the 1980's. The literature indicated the necessity to review economic trends prior to the originally set period (1985-89), therefore it was necessary to review the trends prior to 1985.

Section IV then examines intercountry conditions by conducting a cross-country analysis of the fifteen European countries with a concentrated effort on the growth in the Gross Domestic Product (GDP) and in the unemployment rate. Next, **Section V** provides a country-by-country analysis of the recent macroeconomic trends analyzing the recent trends, the major macroeconomic occurrences in the second half of the

1980's, as well as the 1988 economic outlook for each country separately.

Finally, **Section VI** provides a summary and conclusion on Europe's economic performance in the 1980's. It also briefly presents the major implications of past occurrences and future developments that a U.S. multinational corporation must understand in order to successfully compete in the European and world markets.

II. European Macroeconomic Trends and Developments

This section compares the major macroeconomic developments for the United States (U.S.), Japan, and OECD Europe during the second half of the 1980's. The section will document comparative trends in Gross Domestic Product (GDP) growth, employment/unemployment, inflation, productivity, wages, and major monetary developments for the years 1985-89.

The analysis begins by looking at monetary developments and exchange rate trends because of their importance to the analysis of growth trends especially for U.S. multinational corporations operating in Europe. The analysis of the U.S., Japan, and OECD Europe is then conducted to clearly examine the trends in economic development from the aggregate level. The purpose of this approach is to find out the major facts and trends affecting the economic developments in Europe in the 1980's.

A. Monetary Developments and Exchange Rate Movements

The major monetary development for the 1980's was the Louvre Agreement which took place in Paris in February 1987. The world's six major industrialized countries (the United States, Canada, West Germany, the United Kingdom, France, and Japan) met in France in an attempt to stabilize the uncertainties in the international financial markets. Along with the steep decline of the U.S. dollar **(Table I)** against most major currencies in 1986, the fear of a worldwide

recession brought those countries to set an agreement that would cover economic policies and exchange rate fluctuations. In light of the Louvre Agreement, the United States undertook two commitments:

1. Continue to resist protectionism.
2. Persist efforts to reduce the Federal deficit.

Japan and Germany had reduced their short-term interest rates before the meeting and agreed to continue such policies. Germany had also agreed to introduce a comprehensive tax reform to increase the size of tax reduction for 1988. The six countries also agreed on the view of the stabilization of exchange rates, this agreement would be accommodated by the countries' respective Central Banks (OECD Economic Outlook, 1987).

In the United States, the Federal Reserve had already interfered in the foreign exchange market in August 1987, this was done to save the falling dollar. The Federal Reserve raised the discount rate to 6.5 percent from its previous level of 6 percent. This movement was expected to encourage the foreign investment in the United States and therefore, raise the demand for the U.S. dollar. Inflation began to increase at an increasing rate in the U.S. towards the second half of 1988 as a direct result of other Federal Reserve actions.

Exchange rates stabilized in 1988 with the expectation of a slight drop in the U.S. dollar against the Japanese Yen,

the Deutchmark, the Swiss Franc, and the British Sterling. This marginal drop further reduced the U.S. trade deficit for 1988 as the demand for U.S. products increased. Stabilization of the world economy was considered to be necessary for further growth because of the inconsistencies of economic activities during the past few years. The participants agreed that the 1988 stabilization standard is to be viewed as a fundamental base for setting the tone of the 1990's economies.

Table I. Exchange rates of OECD countries
Spot rates in terms of units of national currency per US $

	1985	1986	1987[a]	1988[a]
United States	1.00	1.00	1.00	1.00
Austria	20.69	15.27	12.77	12.71
Belgium/Luxemb.	59.43	44.67	37.62	37.45
Denmark	10.59	8.09	6.85	6.81
Finland	6.20	5.07	4.44	4.40
France	8.98	6.93	6.04	6.01
Germany	2.94	2.17	1.82	1.81
Italy	1909.40	1491.0	1294.40	1298.60
Netherlands	3.32	2.45	2.05	2.04
Norway	8.59	7.39	6.81	6.73
Portugal	169.93	148.17	143.05	151.35
Spain	170.06	139.97	128.31	128.28
Sweden	8.60	7.12	6.35	6.29
Switzerland	2.46	1.80	1.50	1.49
United Kingdom	0.78	0.68	0.62	0.61

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, Page 127.
[a]Figures for 1987-88 are estimated by the source.

B. OECD Economic Trends (1985-89)

According to **Table II**, growth in real output for the U.S., Japan, and Europe OECD has improved in 1987 and 1988,

but has slowed down somewhat in 1989 from its previous levels. Although the recent trend has been positive, the sluggish growth continues to haunt members of the Organization for Cooperation and Development (OECD). The years 1987 and 1988 show the best performances in output growth for the U.S., Japan and, OECD Europe. However, the year 1989 shows an overall slowdown in growth of output with Japan showing the greatest fall of almost one full percentage point from the year before, while OECD Europe had the best performance with only one-half of a percentage point below its level of the previous year.

Table II. Real GNP/GDP
Percentage changes from previous year

	1960-73++	1973-85++	1985*	1986*	1987+	1988+	1989+
Real GNP/GDP							
United States	3.9	2.5	2.7	2.5	3.4	3.9	3.0
Japan	9.6	3.8	4.7	2.5	4.5	5.7	4.8
OECD Europe	4.7	1.9	2.6	2.5	2.7	3.5	3.0

++ Source: OECD Labour Force Statistics, Historical Statistics.

* Source: OECD, Economic Outlook, 41, page iv & 167, June 1987.

+ Source: OECD, Economic Outlook, 45 & 46, page 4 & 115, June & December 1989.

1. The United States (U.S.)

During the 1980's, the U.S. economic recovery has been accompanied by a continuous reduction in the jobless rate of

employment **(Table III)**. In the later half of the 1980's, the U.S. was successful in lowering its unemployment rate in each of the years from 1985-89. The improvement was accompanied by moderate growth rates in GDP from 1986-88, in contrast to the sluggish growth rates experienced in the earlier part of the decade **(Figure I)**.

Table III. Unemployment rate
Percent of the labor force

	1985*	1986*	1987+	1988+	1989+
United States	7.1	6.9	6.2	5.5	5.2
Japan	2.6	2.8	2.8	2.5	2.3
OECD Europe	11.1	11.0	10.1	9.6	9.0

* Source: OECD, Economic Outlook, 41, page iv & 167, June 1987.

+ Source: OECD, Economic Outlook, 45 & 46, page 4 & 115, June & December 1989.

The U.S. labor market also was characterized by increases in wages from 1986-88. As shown in **Table IV**, the percentage change in wages over the period was well above the previous growth rates of 1983-86. Even with the slight decline in 1989, the average growth in wage rates for 1987-89 was at almost 6 percent per year while the average for the previous period of 1983-86 was at 4.3 percent per year.

Taking into account that inflation for the 1987-89 period only increased moderately by .6 of a percentage point from its level of 1983-86, this moderate increase was

significantly impacted by the 1989 level of 5.0 percent. The fact that wage rates have been rising consistently in the second half of the 1980's, and that unemployment rates have been steadily declining for the same period is an indication of the emphasis put forth by the U.S. to reduce the jobless rate (through increase of the job market - expansionary policies) as a means to improve growth. This strategy has worked well for the U.S. in accomplishing its goals of economic growth, reduction in the jobless rate as well as improving wages.

Table IV. Productivity, Wages, and Inflation
Percentage changes from previous year

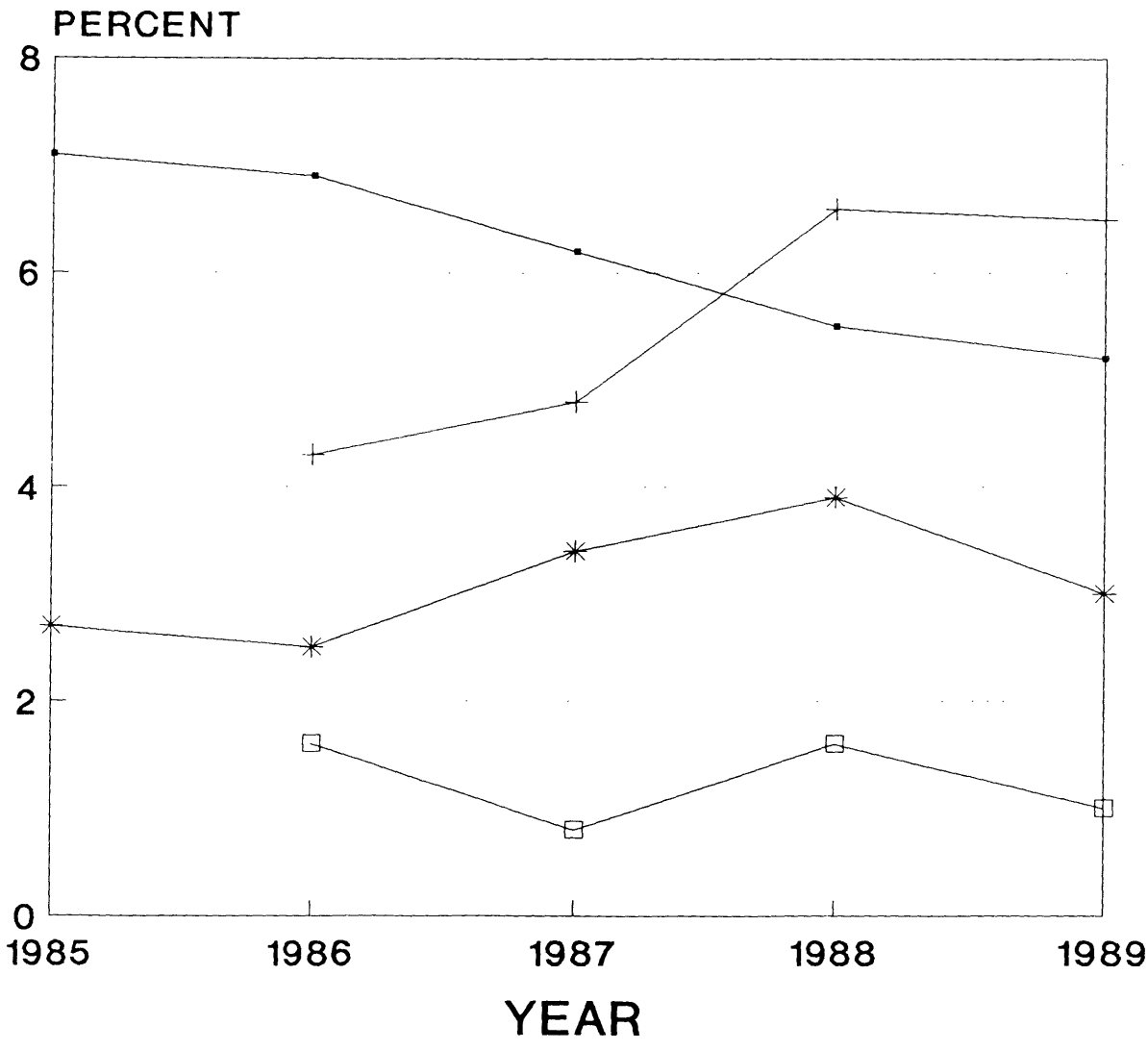
	Average 1983-86	1987	1988	1989
Productivity				
United States	1.6	0.8	1.6	1.0
Japan	3.0	3.5	3.9	3.5
OECD Europe	2.0	1.6	2.2	2.0
Wages[(a)]				
United States	4.3	4.8	6.6	6.5
Japan	3.0	1.9	3.9	5.0
OECD Europe	7.6	5.5	6.2	6.0
GNP Implicit Price Deflator				
United States	3.3	3.3	3.4	5.0
Japan	1.3	-0.2	0.4	1.5
OECD Europe	6.6	4.3	4.9	5.3

Source: OECD, Economic Outlook, 45, page 4, June 1989.

[(a)] Earnings per employee (excludes employers's social security contributions)

Figure I

UNITED STATES



Unemployment rate, GDP-Wages-Productivity (%chg)
Wages and Prod. figures for 86 are averages of 83-86

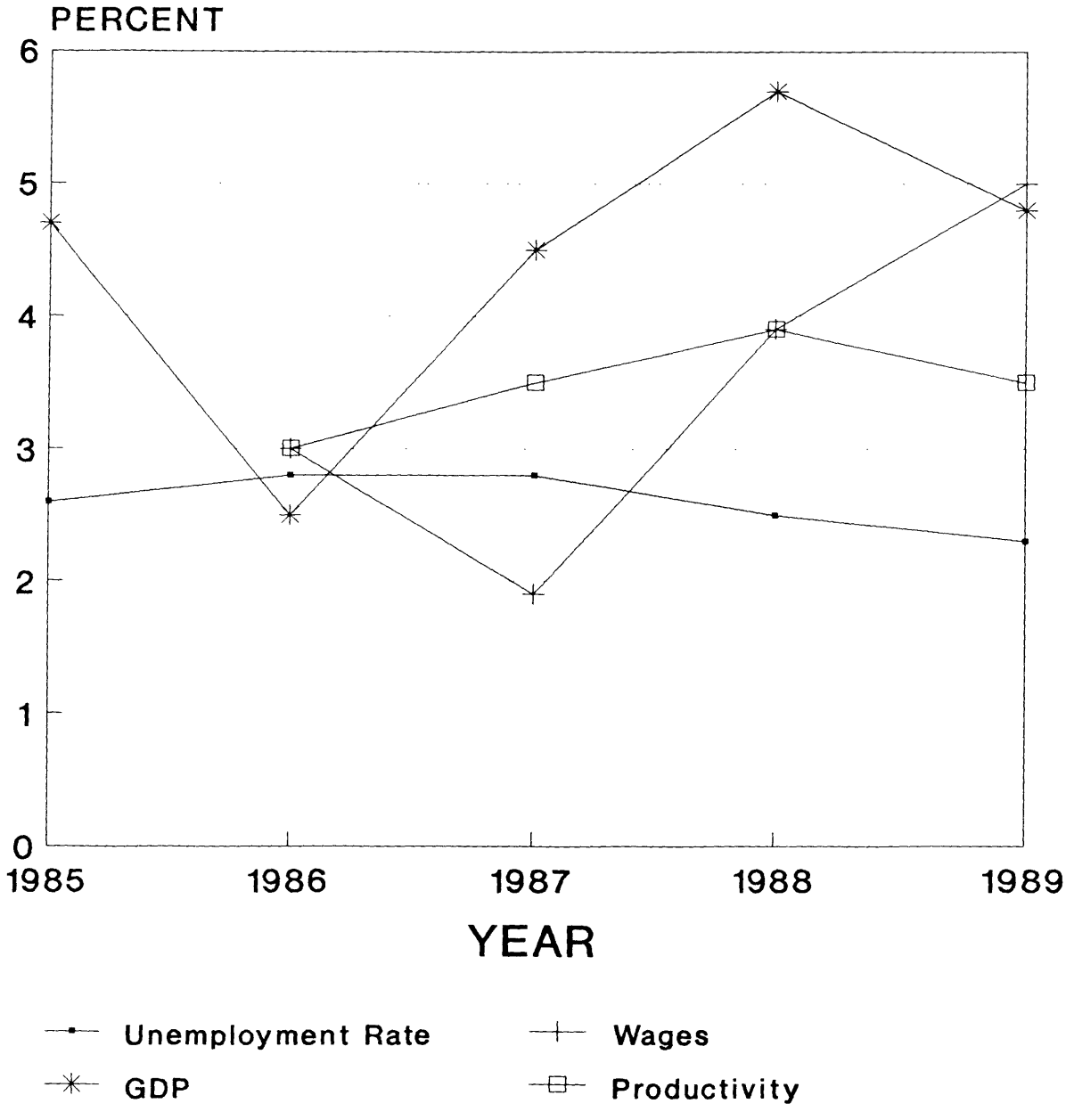
2. Japan

On the other hand, the Japanese unemployment rates for the 1980's averaged 2.6 percent of the labor force for the 1985-89 period, with a 1989 low of at 2.3 percent **(Table III)**. An interesting situation appeared in Japan is the unemployment rate had declined in 1988 and 1989 as the wage rate had increased for the same period, while the growth in GDP experienced its first decline in 1989 (the first decline in three years). By looking at **Figure II,** there appears to be a slight lag between changes in the unemployment rate, wages, and GDP growth. The decline in GDP growth for 1989 may just be caused by the decline in productivity despite the improvement in the employment level for the same year; its first decline in more than 5 years.

Unemployment increased in 1986 by .2 of a percentage point from its level of 1985 as GDP growth decreased by 2.2 percentage points. Japan dealt with this problem by slowing down the increases in wage rates in 1987. This strategy stabilized the unemployment rate (zero percentage change from previous year) for 1987 while helped the growth in GDP improve by two percentage points from its level of 1986 **(Table III)**. The positive results proved beneficial in 1987, Japan experienced a huge payoff in all areas of its economic performance; that is, reduction in the jobless rates accompanied by great improvements in the growth rates and increases in wages.

Figure II

JAPAN



Unemployment rate, GDP-Wages-Productivity (%chg)
Wages and Prod for 86 is an average 83-86

3. OECD Europe

The growth in the OECD Europe's GDP has been comparable to that of the U.S. for the later part of the decade. From 1987 to 1989, GDP has been growing at an average of 3.1 percent per year, out performing the previous levels of 1985 and 1986 of 2.6 and 2.5 percent respectively **(Table II)**. In 1985, OECD Europe had an incredible 11.1 percent unemployment rate; 4 percentage points above the U.S. level and an amazing 8.5 percentage points higher than the Japanese level for the same year **(Figure III)**.

Although experiencing higher inflation levels (Table IV) than the U.S. and Japan, the OECD European countries have also experienced higher increases in wages than their counterparts across the Atlantic and Pacific. However, by looking at the trend lines **(Figure IV)**, the trend for increases in wages is declining for OECD Europe while increasing for Japan and the U.S.. The U.S. wage trend line has the same slope as Japan's but at a higher plateau. **Figure III** clearly depicts how the OECD European countries have been responding to the high unemployment; wages have been declining steadily (with the exception of 1988) while growth and productivity have been moderately improving.

In the year 1989, the OECD unemployment rate was at 9 percent down from a high of 11.1 percent in 1985. However, at 9 percent of the labor force, the unemployment is still very high in Europe especially when compared to unemployment

rates in the U.S. and Japan **(Figure V)**.

In summary, the European economic performance for the latter part of the 1980's has been consistent with the U.S. and Japan. However, European unemployment has been high and persistent. The following section will discuss the various reasons behind this phenomenon as seen by other economists, and it offers its own discoveries as to why European unemployment has been persistently high.

Figure III

OECD EUROPE

Unemployment rate, GDP-Wages-Productivity (%chg)
Wages and Prod. figures for 86 averages of 83-86

Figure IV

WAGES

trend lines

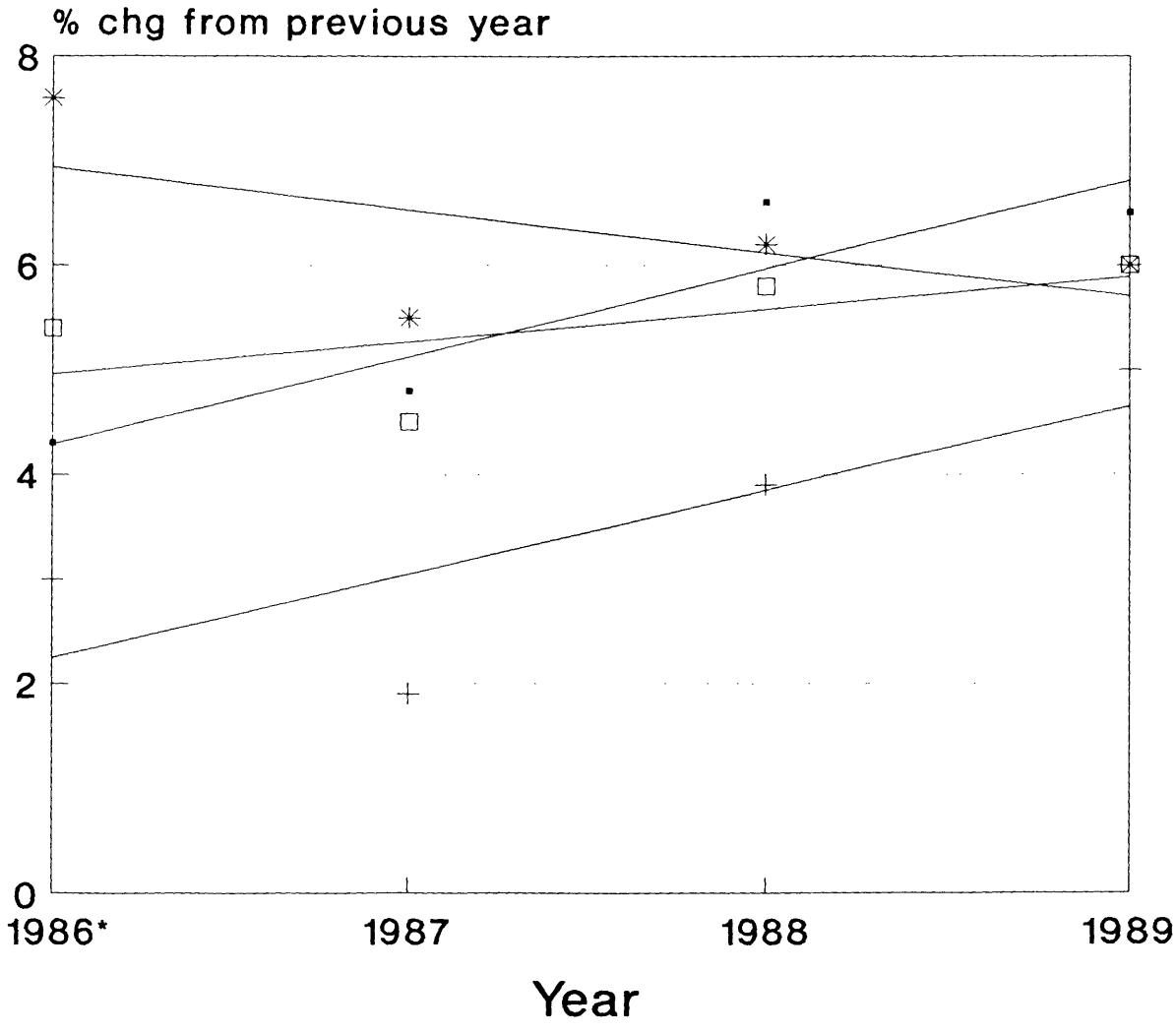
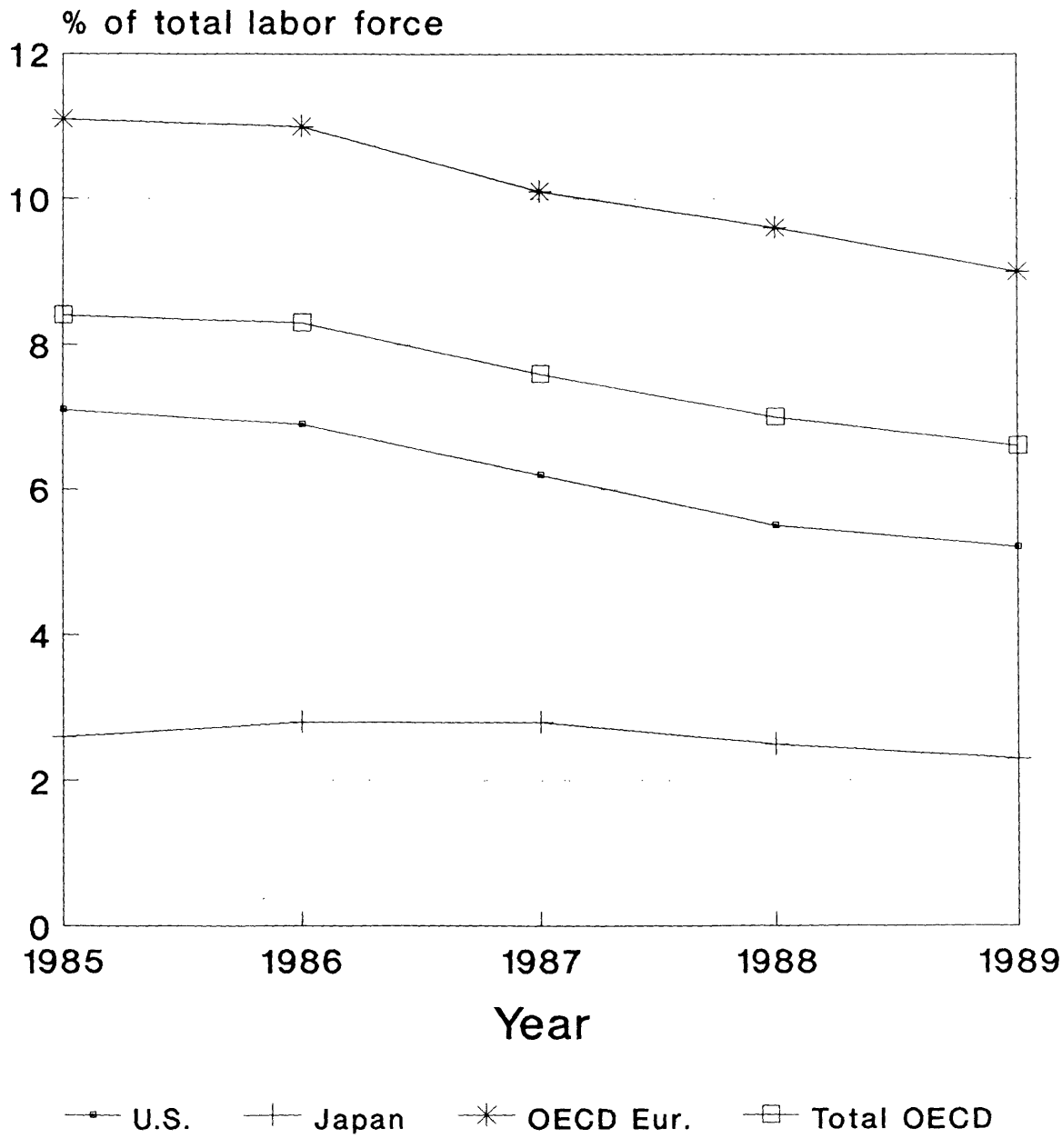


Figure V

Unemployment Rate



III. Causes of High Unemployment in Europe

According to Ergas and Shafer, commenting on the high European unemployment,

> "Large pools of unemployed represent an enormous waste of resources in OECD countries....Well oiled labor markets are thus needed to reduce unemployment". (Ergas and Shafer, 1987).

The authors imply that through a lower unemployment rate, a larger market will be created. This newly created market will contribute to higher corporate profitability (vis-a-vis a reduction in wages), and will have a positive impact on the growth in output above and beyond what has been experienced in the 1980's. In this quote, Ergas and Shafer also imply that rigidities exist in the European markets preventing the European labor market from being "well oiled".

To understand and to fully explain the phenomenon of persistent high unemployment levels in Europe - although they have been declining in the last four years as mentioned - Blanchard and Summers (1988) stress the importance of understanding past occurrences that pushed unemployment upwards in the early 1980's.

In the period of 1973-86, as shown in **Table V**, the unemployment rate in OECD Europe increased from an average of 3 percent to 11 percent. In the U.S. and Japan, the unemployment rate rose by 2 percentage points for the same period (Glyn and Rowthorn, 1988). This, along with the slowdown in productivity growth have pushed up the minimum

rates of unemployment that are obtainable without accelerating inflation (Ergas and Shafer, 1987).

According to Ergas and Shafer (1987), OECD economists have attempted to measure the non-accelerating inflationary rate of unemployment (NAIRU) and found that for the mid 1980's, this rate was 2 1/2 percent for Japan, 6 percent for the U.S., 7 percent for Germany and France, and 9 percent for Italy. In the period 1985-88, the average unemployment rate for Germany was 8.1 percent, for France 10.9 percent, and 11.1 percent for Italy. They concluded that there is big room for macroeconomic expansion in Europe that would allow for reduction in unemployment without having too much effect on the inflation levels.

Table V. Macroeconomic Trends
Average percent growth rates

	Europe	U.S.	Japan
POPULATION			
1960-73	0.7	1.7	1.7
1973-85	1.0	1.4	0.9
Change	0.3	-0.3	-0.8
PARTICIPATION RATE			
1960-73	-0.3	0.3	-0.4
1973-85	-0.2	0.7	0.1
Change	0.1	0.4	0.5
LABOR FORCE			
1960-73	0.4	2.0	1.3
1973-85	0.8	2.1	1.0
Change	0.4	0.1	-0.3
PRODUCTIVITY			
1960-73	4.3	1.9	8.3
1973-85	1.8	0.6	3.0
Change	-2.5	-1.3	-5.3
EMPLOYMENT			
1960-73	0.4	2.0	1.3
1973-85	0.1	1.9	0.8
Change	-0.3	-0.1	-0.5
UNEMPLOYMENT			
1960-73[a]	0.0	0.0	0.0
1973-85[a]	0.6	0.2	0.1
Change	0.6	0.2	0.1

Source: OECD Labour Force Statistics, Historical Statistics.

[a] These statistics refer to the annual increase in the percentage unemployment rate (i.e., first difference); all other statistics refer to proportionate growth rates.

Also, according to the macro theory, the rate of inflation is influenced by the unemployment rate. Bernanke & Parkinson (1989) tested this theory by comparing the unemployment phenomena in Europe in the 1980's to that of the

U.S. during the great depression of the 1930's. They conclude that the "level of unemployment has little independent influence on the rate of inflation". (Bernanke and Parkinson, 1989).

However, they argue that the situation in Europe has demonstrated a different characteristic. Europe has been experiencing high unemployment as well a rising rate of inflation. This characteristic is more consistent with the "floating NAIRU" theory. Under this theory, inflation is determined by the supply and demand of the money stock. According to the theory, "Inflation surprises... or inflation itself may have little effect on employment...Presumably, monetary condition also explain continued inflation in Europe today". The "floating NAIRU" theory emphasizes the importance of paying attention to the real wage rigidities, already existing in Europe, rather than relying on inflation levels to explain the high unemployment in Europe. (Bernanke and Parkinson, 1989).

At this point, it is important to find out whether the European unemployment is "Classical" or "Keynesian".

> "Traditional Keynesian policies may be impeded by the belief that rising unemployment (in Europe) is not so much 'Keynesian', arising from shortfalls in aggregate demand, as it is 'Classical'; originating from a failure of real wages to adjust to changing market conditions, particularly reduced rates of productivity growth" (Bernanke and Parkinson, 1989).

It follows that the demand for labor is not dependent on real wages in the "Keynesian" state while it is mainly dependent on real wages in the "Classical" state (Coen and Hickman, 1988). Coen and Hickman argue that while the "Classical" and the "Keynesian" theories explain the "states" of employment, they do not explain the "shocks" causing unemployment to move upwards. For example, a wage shock, that may or may not be caused by deflationary monetary or fiscal policies, could cause real wage to increase above the full employment level, and in turns causing the aggregate demand (the Keynesian state) and output (the Classical state) to fall. Thus, any type of shock could explain either type of unemployment. (Coen and Hickman, 1988).

According to Blanchard and Summers (1988), although the Classical theories imply that high unemployment is caused by structural changes that raised the equilibrium unemployment to its current level, the United Kingdom has had a conservative government in the 1980's that has attacked the welfare state and called it a barrier to free market. The British government has significantly liberalized the labor market to eliminate the barriers and to let free market mechanisms operate to reduce the high unemployment in the U.K.. This has apparently failed since unemployment in the U.K. continues to be very high. Blanchard and Summers continue their argument by attacking the Keynesian theory, which explains the situation as "cyclical disturbances that

have driven the unemployment rate above its natural level". The cyclical disturbances include the monetary contraction in the beginning of the 1980's was by a period of "fiscal austerity" causing the high unemployment experienced today. Blanchard and Summers also point out that since disinflationary policies began in the United Kingdom in 1979, unemployment more than doubled but yet, "the labor market appears to be in equilibrium"!. (Blanchard and Summers 1988).

To summarize, Bernanke and Parkinson; Coen and Hickman; and Blanchard and Summers have presented arguments for and against the Classical and the Keynesian views to explain the high unemployment rate in Europe. Although the various arguments presented show logic and poise, these economists have not been able to reach a consensus on the validity of the Natural Rate Hypothesis and the Classical and the Keynesian explanations of the European unemployment problem. The remainder of this section offers an alternative explanation of the unemployment problem in Europe. It views the cause of European unemployment as a combination of factors that must be separately examined to get a better understanding of European unemployment. The three main causes of Europe's high unemployment rate, as discussed in this section are: productivity, population growth and structural changes, and real wage rigidities.

A. Productivity

In contrast with the U.S. 1930 depression, productivity growth in Europe in the 1980's has been above that the U.S. rate. Coupled with the fact that growth in wages prior to 1987 outpaced wage growth in the U.S. and Japan **(Table IV)**, this finding confirms the truthfulness of the old saying: "higher wages and better treatment of labor would improve productivity" (Bernanke and Parkinson, 1989). This view is also supported by Summers (1988) who suggests that "efficiency wages" is the key to understanding the European unemployment. (Summers, 1988).

B. Population Growth and Structural Changes

It is equally important to examine the growth in population to understand the European unemployment. This factor appears to have been neglected in the literature of European unemployment. Population expanded faster in Europe after 1973 than it did prior to 1973, while in the U.S. and Japan it grew slower. As population in Europe accelerated after 1973, so did its labor force. However, employment grew more rapidly in the U.S. after 1973 than it did in Europe **(Table V)**. On the other hand, productivity-to-output growth slowed down more in the U.S. and in Japan more than it did in Europe. The result was that in Europe, growth in labor demand lagged behind growth in labor supply, resulting in a persistently high unemployment rate.

Glyn and Rowthorn (1988) found that for every one

percent increase in the population growth there was a .43 percent contribution to unemployment, and for every one percent decrease in industrial jobs increased unemployment by .23 percent for the 1973-85 period. This pattern was even more significant in the 1979-85 period. This would suggest that industrial unemployment resulting from structural change is a key factor to explaining high European unemployment rate. This type of unemployment is not cyclical since it floods the market with "immobile middle-aged workers, lacking the skills required for immediate redeployment elsewhere in the economy". Moreover, the areas that experienced greater declines in industrial jobs had slower growth in the service employment as a result, unemployment rate in these areas tend to be extremely high (Glyn and Rowthorn, 1988).

Countries that have experienced great loses in industrial employment - such as France, U.K., and Spain which have lost industrial jobs at 2.4-3.8 percent per year - have also experienced very high unemployment rates even though their service employment grew very rapidly (Glyn and Howthorn, 1988).

Glyn and Howthorn (1988, excellent article), defend the NAIRU which has fallen under criticism for having "enormous variations" through time and between countries. The NAIRU states that a rise in the actual unemployment rate will increase the "equilibrium" rate of unemployment and wages at the aggregate level. Glyn and Howthorn's concept of

industrial unemployment is consistent with the NAIRU from a structural change viewpoint only because as industrial unemployment increases, the industrial unemployed is "isolated" from the labor market and therefore has little or no effect on wage bargaining (Glyn and Howthorn, 1988).

C. Fragmented Wage-Setting - Downward-Slopping Labor Supply; Real wage "Rigidity"

The "fragmented" wage setting - a form of collective bargaining between labor unions and firms where the "basic legal framework for bargaining has been poorly spelt out in terms of the rights and responsibility of labor and management; this has contributed both to fragmentation and to relatively high levels of industrial conflict" in the U.K., France, Italy, and Belgium. In these countries, unions competing with each other causing overlapping and complexity in the negotiations with firms. This, as pointed out by Ergas and Shafer, causes these countries to be more susceptible to inflation or higher unemployment or both (Ergas and Shafer, 1987).

The Downward-Slopping of the labor supply curve's version of the "fragile equilibria" presented by Blanchard and Summers (1988). This theory basically demonstrates labor union members simply set wages at a level that secures the employment of their current members but, do not permit the firms to do any hiring. Therefore, as employment decreases, the demanded wages, of employed members, increases (serves as a security blanket), causing the labor supply

curve to actually slope downwards (contrary to the Phillips curve) (Blanchard and Summers, 1988).

The "fragmented wage-setting" and the "Downward-sloping labor supply curve" theories are in essence very similar in the way labor unions interfere and control the negotiations between firms and employees. This situation is referred to by Ergas and Shafer as not "well oiled" labor markets.

In summary, the European unemployment rate has been declining since 1986 in a pattern that is consistent with the macro theory where wages and unemployment rates move together (i.e., as the unemployment rate decreases, the wage rate decreases and vice versa). The rising unemployment rate prior to 1986 WAS NOT. In my view, the primary contributors of this behavior were productivity trends, population growth and structural change, and real wage rigidity.

IV. Intercountry Comparison of Economic Performance

The previous section described, in aggregate Europe, the main contributing factors to the high European unemployment rate. This section takes a closer look at the European economy in the second half of the decade by comparing the fifteen OECD European countries to each other for growth in GDP and for unemployment to find out which countries have been the driving force behind the high unemployment in Europe.

According to **Table VI**, for most European countries, GDP has been increasing at a decreasing rate for the 1985-88 period. France, Austria, and Denmark GDP growth increased by .75 of a percentage point between 1987 and 88 in the GDP growth. On the other hand, Norway and the United Kingdom experienced a slowdown in GDP growth of one and one-half and a full percentage point respectively over the same period.

Table VI. Gross Domestic Product Percentage Changes

	1985	1986	1987	1988
Austria	3.00	1.70	0.75	1.50
Belgium	1.50	2.30	1.25	1.75
Denmark	4.20	3.40	-0.75	0.00
Finland	3.00	1.80	2.75	2.50
France	1.40	2.00	1.25	2.00
Germany	2.50	2.40	1.50	2.00
Italy	2.30	2.70	3.00	2.50
Luxembourg	2.90	2.00	2.50	2.25
Netherlands	1.70	1.90	2.50	1.75
Norway	5.40	3.80	2.75	1.25
Portugal	3.30	4.80	3.50	3.75
Spain	2.20	3.00	3.00	2.75
Sweden	2.20	1.30	1.75	1.50
Switzerland	4.00	2.80	1.75	2.00
United Kingdom	3.50	2.70	3.25	2.25

Source: OECD, Economics and Statistics Department, Economic Outlook.

Almost half of the fifteen countries reviewed experienced double-digit unemployment rates led by Spain, Netherlands, France, Belgium, Italy, United Kingdom, and Denmark. Ranging from 10 percent of the labor market in Denmark to 20.50 percent in Spain, the unemployment rate for these countries averaged 12.8 percent of the labor force in 1988 **(Table VII)**. Although France experienced the highest gain in the GDP growth between 1987 and 1988, it also experienced the largest increase of .75 of a percentage point in the unemployment rate. As discussed in **Section III**, this trend is consistent with the wage rate rigidity hypothesis. The United Kingdom, on the other hand, experienced a sharp reduction in its unemployment rate in 1987 and 1988. The

U.K. had a one-half of a percentage point drop in its unemployment rate accompanied by a slowdown in the growth of GDP.

Table VII. Unemployment rate
Percent of the labor force

	1985	1986	1987	1988
Austria	3.60	3.40	4.00	4.50
Belgium	12.00	11.40	11.75	12.00
Denmark	9.00	7.80	8.50	10.00
Finland	5.00	5.50	5.25	5.50
France	10.20	10.50	11.25	12.00
Germany	8.30	8.00	8.00	8.25
Italy	10.10	10.90	11.50	11.75
Luxembourg	1.50	1.50	1.25	1.75
Netherlands	14.30	13.30	12.75	12.75
Norway	2.50	1.90	2.25	3.00
Portugal	9.00	8.70	8.75	8.50
Spain	21.90	21.50	21.00	20.50
Sweden	2.30	2.20	2.25	2.50
Switzerland	1.00	0.80	1.00	1.00
United Kingdom	11.70	11.80	11.25	10.75

Source: OECD, Economics and Statistics Department, Economic Outlook.

V. Country-by-Country Analysis

The previous section emphasized intercountry comparisons of a number of performance indicators. This section will carry the discussion of Europe's economic behavior a step further by examining specific economic trends and developments within each of the fifteen OECD European countries. It reviews the major trends in the respective countries as it related the macroeconomic indicators to the internal occurrences of the countries for 1985-88 to better understand the European economic behavior in the latter part of the 1980's.

1. AUSTRIA

Real Gross Domestic Product (GDP) growth slowed to 2.0 percent in 1986, a 1.7 percent increase from the prior year and expected to decline to 1.0 percent in 1987 (OECD Economic Outlook, 1987). The slowdown of GDP growth was attributed to the decline in exports that were partially caused by the appreciation of the local currency. The unemployment rate decreased to 3.4 percent in 1986 and is expected to increase to 4.0 percent in 1987. During 1986, consumer prices rose by only 1.5 percent from the previous year primarily due to the sharp decline in oil prices that started in the fall of 1985 **(Table VIII)**.

1988 Outlook:

The continued appreciation of the local currency (caused by the sharp depreciation of the U.S. dollar against major

OECD currencies) caused a decline in real net exports; however, demand is expected to grown at a slow pace in 1988, because of the inverse relationship in the export levels, causing GDP to grow modestly for the same year, unemployment will suffer a little in 1988.

Table VIII. AUSTRIA
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	6.00	3.70	1.50	2.25
Exports of Goods and Services	7.10	-2.40	-0.75	1.50
Imports of Goods and Services	7.10	1.80	1.75	3.00
GDP	3.00	1.70	0.75	1.50
Total Domestic Demand	2.90	3.20	2.00	2.25
Memorandum Items				
Consumer Prices	3.40	1.50	1.75	2.50
Unemployment Rate	3.60	3.40	4.00	4.50

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 109.

Major 1988 Occurrences:

The government plans to reduce the fiscal deficit for the short run which will have a positive effect on the investors' confidence level and will eventually appreciate the local currency.

2. BELGIUM

Low oil prices in 1986 kept consumer prices low and stable. Exports increased by 4.4 percent which caused fixed capital investments to increase and, lowered the unemployment rate to 11.4 percent. Because of the budget deficit that Belgium has been experiencing, discount rates have been

increasing. However, the Belgium government is trying to keep the discount rate as low as possible. In January 1987, the discount rate was raised to 8.5 percent and by May 1987, the rate was dropped to 8.0 percent. Real wage rates have been increasing along with taxes which caused a slowdown in consumer demand in 1987; that in turns pushed the unemployment rate to 11.75 percent by the end of 1987. GDP growth also slowed to 1.25 percent **(Table IX)**.

1988 Outlook:

The slowdown of GDP growth in 1987 will push the unemployment rate upward slightly to 12 percent. Consumer prices will increase very little from the previous year because energy prices are expected to continue to be at the same level as in 1987.

Table IX. BELGIUM
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	1.20	5.30	2.75	2.75
Exports of Goods and Services	2.20	4.40	3.25	3.75
Imports of Goods and Services	1.90	6.20	3.50	4.24
GDP	1.50	2.30	1.25	1.75
Total Domestic Demand	1.30	3.40	1.25	1.75
Memorandum Items				
Consumer Prices	4.80	1.40	1.50	1.75
Unemployment Rate	12.00	11.40	11.75	12.00

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 110.

Major 1988 Occurrences:

1. Belgium will be moving towards privatization of

companies; by the end of 1988, the government would have sold three state owned companies (the gas utility, the state shipping line, and the government's housing loan company). This privatization program will help cut its deficit to BFr 405 billion (7.5 percent of GDP) (OECD Economic Outlook).

2. Implementation of the new income tax laws; the top marginal rate will drop to 50 percent from the present level of 72 percent. Since government revenues will be reduced, the new law should recoup that amount by reducing tax deductible allowances on professional costs (business lunches and company cars, etc.).

3. DENMARK

The 1986 total domestic demand grew by the same level as it did in 1985 while exports decreased sharply and imports decreased moderately, the trade deficit gap widened in 1986. Unemployment rate declined as a direct result of the growth in total domestic demand and fixed capital investment. In October of 1986, Denmark took measures to encourage savings and discourage borrowing through tight fiscal policies and through tax incentives to savings. These measures caused the deceleration in total domestic demand in 1987; which in turns is slowing fixed capital investment and pushing the unemployment rate upward to about 8.5 percent **(Table X)**.

1988 outlook:

The appreciation of the Krone in 1987 will keep the trade balance at its level of 1987. Consumer prices will

increase moderately because of the tight fiscal policy of 1986 while the unemployment rate will increase by 1.5 percentage points as a result of a 4-percentage point increase in imports.

Table X. DENMARK
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	11.90	16.80	-6.50	-6.00
Exports of Goods and Services	4.20	0.20	0.50	1.75
Imports of Goods and Services	8.60	6.50	-4.00	0.00
GDP	4.20	3.40	-0.75	0.00
Total Domestic Demand	5.70	5.70	-2.50	-0.50
Memorandum Items				
Consumer Prices	4.90	3.60	4.00	2.50
Unemployment Rate	9.00	7.80	8.50	10.00

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 111.

4. FINLAND

The 1986 Finnish growth in GDP was 1.8 percent over its previous level of 1985. Low oil prices helped consumer prices to grow by only 3.6 percent which represents a 2.4 percentage point decline from its 1985 growth level. During the 1986-87 period, imports and exports have been growing at a decreasing rate. Imports grew by only 3.75 percent of its previous level (a 2.45 percentage point decline) while exports grew by only 1.5 percent of its level of 1986 (a .3 of a percentage point decrease). The trade deficit of 1985-86 which has helped consumer prices to rise moderately in 1987, should continue in 1988 **(Table XI)**.

Table XI. FINLAND
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	3.00	-0.10	3.75	2.25
Exports of Goods and Services	0.60	1.80	1.50	2.00
Imports of Goods and Services	6.30	6.20	3.75	2.75
GDP	3.00	1.80	2.75	2.50
Total Domestic Demand	3.30	2.10	3.25	2.50
Memorandum Items				
Consumer Prices	6.00	3.60	3.75	4.00
Unemployment Rate	5.00	5.50	5.25	5.50

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 112.

1988 Outlook:

Tight fiscal policy will slow down GDP (OECD Economic Outlook, 1987) in 1988 which will push the unemployment rate upward to 5.5 percent as total domestic demand decelerates in 1988 (OECD Economic Outlook, 1987).

5. FRANCE

The 1986 economic situation improved somewhat from the year before; total domestic demand grew rapidly at 3.8 percent that caused imports to increase to 7.1 percent and fixed capital investment to continue at that pace for 1987 and 1988. Since 1986, exports dropped sharply, reflecting inventory imbalances, the economic situation in 1987 has slowed a little. Growth will be slow by the end of 1987 which will worsen the unemployment level **(Table XII)**.

1988 Outlook:

Continued gradual growth, fixed investment and domestic

demand are expected to rise moderately which will cause the employment rate to rise. However, the rise in employment level will be offset by the rise in the labor supply. The net result on the unemployment rate will be negative which will cause wage rates to slow for 1988. The slowdown in wage rates will push inflation downwards almost a full percentage point.

Table XII. FRANCE
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	3.20	4.20	3.00	3.75
Exports of Goods and Services	2.40	0.10	2.50	3.75
Imports of Goods and Services	5.20	7.10	4.00	4.00
GDP	1.40	2.00	1.25	2.00
Total Domestic Demand	2.10	3.80	1.75	2.25
Memorandum Items				
Consumer Prices	5.50	2.20	3.25	2.50
Unemployment Rate	10.20	10.50	11.25	12.00

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 113.

Major 1988 Occurrence:

Spring 1988, France's presidential election can cause a little disturbance in the economy; President Mitterrand's socialist party that expects to win, will concentrate on the following issues:

a. Better schooling
b. Better job training
c. Tax breaks to encourage investment

6. GERMANY

1986 was the year that marked the decline of the four-year old upward trend of the German's economic activity. The sluggish development in exports was largely attributed to the exchange rates that induced losses in competitiveness. Large improvement in business investment in 1986 along with the increase in total domestic demand helped the unemployment rate to be reduced to 8 percent, while GDP grew by the same level as in 1985. Consumer prices dropped sharply due to the decline of oil prices that caused an understatement of the German imports **(Table XIII)**.

Table XIII. GERMANY
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	-0.40	3.30	1.25	2.75
Exports of Goods and Services	7.30	-0.50	-1.00	1.00
Imports of Goods and Services	4.70	3.20	3.00	3.75
GDP	2.50	2.40	1.50	2.00
Total Domestic Demand	1.50	3.70	2.75	2.75
Memorandum Items				
Consumer Prices	2.10	-0.40	0.75	1.50
Unemployment Rate	8.30	8.00	8.00	8.25

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 76.

1988 Outlook:

Total production may grow by a modest 2 percent. Tax incentives will be given as an implementation stage of the Louvre Agreement of February of 1987, to stimulate European economies and to encourage the exports of the United States.

Consumer prices are expected to look favorable for 1988 because of the contractionary monetary policy exercised in Germany.

7. ITALY

The 1986 economic developments were generally favorable; GDP grew by 2.7 percent accompanied by a slowdown in inflation and a 3.2 percent increase in total domestic demand. Imbalances in the labor markets took place as wages increased although the unemployment rate also increased. The wage rates increase will continue to encourage total domestic demand in 1987. Investment should also show a good improvement in 1987; however, the pressures caused by the increasing domestic demand is likely to affect exports in a negative way because of the deterioration of the Italian competitiveness **(Table XIV).**

1988 Outlook:

In general, Italy's economic conditions will slowdown slightly in 1988. The unemployment rate will rise as the total domestic demand declines. Consumer prices will rise as a result of the wage rate increase of 1986 and 1987. Finally, the Lire will stop the appreciation it has experienced in 86-87 economic boom. Most indicators so far have indicated that the Lire may depreciate in 1988; however, exports are

Table XIV. ITALY
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	4.10	1.20	4.50	3.25
Exports of Goods and Services	8.20	3.00	1.25	3.75
Imports of Goods and Services	9.40	5.20	7.00	7.00
GDP	2.30	2.70	3.00	2.50
Total Domestic Demand	2.40	3.20	4.50	3.25
Memorandum Items				
Consumer Prices	9.40	6.10	4.75	5.00
Unemployment Rate	10.10	10.90	11.50	11.75

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 100.

expected to gain in 1988, this would help stabilize the Italian currency. Those developments will enable Italy to enjoy a steady 1988 growth in GDP with very low inflation rate of 5 percent as compared to 21 percent in 1980.

8. LUXEMBOURG

Activities in the steel sector weakened in 1986 (OECD Economic Outlook, 1987), causing growth of GDP to increase by only 2 percent. Real wages increased in 1986 which helped investment to increase while unemployment rate decreased. Luxembourg is pursuing an expansionary fiscal policy through reduction of taxes in order to stimulate investment which has been rising during the first half of 1987 **(Table XV)**.

1988 Outlook:

In 1988, Luxembourg will experience low unemployment rate and rising real wages, fixed capital investment will continue to grow in 1988 at the expense of a moderate rise in

consumer prices. Should the steel industry slow further, GDP will experience a greater slowdown.

Table XV. LUXEMBOURG
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	2.10	2.90	4.00	4.50
Exports of Goods and Services	7.80	3.30	2.50	3.25
Imports of Goods and Services	5.80	3.60	3.50	4.00
GDP	2.90	2.00	2.50	2.25
Total Domestic Demand	0.80	2.30	3.25	3.00
Memorandum Items				
Consumer Prices	3.40	0.00	1.00	1.75
Unemployment Rate	1.50	1.50	1.25	1.75

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 116.

9. NETHERLANDS

In 1986, domestic demand contributed more to GDP growth than exports did. The increase in domestic demand caused fixed capital investment to increase and unemployment rate to decrease. Netherlands is pursuing an accommodating monetary policy with short term interest rates to keep the Guilder at a constant level with the Deutchmark even though the agreement between the central bank and the commercial banks to reduce the lending volume was renewed **(Table XVI)**.

1988 Outlook:

The 1987 consumer prices have been declining as a result of the decreasing price of natural gas and expected to increase slightly in 1988. Growth in GDP is also expected to decelerate in 1988; however, with a tighter margin of trade

deficit, unemployment rate is expected to be within its 1987 range.

Table XVI. NETHERLANDS
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	3.90	8.00	3.25	2.00
Exports of Goods and Services	4.60	2.60	2.25	2.25
Imports of Goods and Services	5.70	4.20	4.00	2.75
GDP	1.70	1.90	2.50	1.75
Total Domestic Demand	2.30	2.80	2.50	1.75
Memorandum Items				
Consumer Prices	2.60	0.00	-0.50	0.25
Unemployment Rate	14.30	13.30	12.75	12.75

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 117.

10. NORWAY

The growth in 1986 was only 3.8 percent from the previous year. The drop of oil prices along with a depreciating Krone put Norway in a trade deficit in 1986. Real wages continued to increase sharply caused consumer prices to increase by 7.5 percent from its 1985 level. Tight fiscal policies (less government consumption) continued in 1987 as was in 1986 in an attempt to slow down inflation is expected to continue in 1988. Interest rates have been increasing to slow down the depreciation of the Krone which in turn will help the trade deficit to decline **(Table XVII)**.

Table XVII. NORWAY
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	-12.00	24.40	-5.00	-5.50
Exports of Goods and Services	10.70	1.00	5.25	2.25
Imports of Goods and Services	6.50	8.80	-3.00	-2.25
GDP	5.40	3.80	2.75	1.25
Total Domestic Demand	3.10	7.80	-1.50	-1.00
Memorandum Items				
Consumer Prices	5.80	7.40	8.50	5.25
Unemployment Rate	2.50	1.90	2.25	3.00

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 119.

1988 Outlook:

Tighter fiscal policies will help consumer prices to decline, and higher interest rates in 1987 will stop the depreciating Krone which will cause a decline in the trade deficit. Unemployment rate is expected to increase only marginally, and therefore, the growth in Norway's output will decline to 1.25 percent.

11. PORTUGAL

In 1986, Portugal experienced good economic conditions that will affect 1987 and 1988 positively. Total domestic demand had the largest upward move of all other economic indicators; at 7.6 percent growth in total domestic demand, the unemployment rate dropped to 8.7 percent in 1986 and will remain steady in 1987. Fixed capital investment grew vigorously in 1986 and expected to continue in 1987. Inflation in 1986 fell nearly 8 percentage points from the

previous year's level. Nominal interest rate will drop with inflation in 1987 which will cause real interest rates to grow slightly **(Table XVIII)**.

Table XVIII. PORTUGAL
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	-3.00	9.50	9.00	7.50
Exports of Goods and Services	11.10	7.70	4.50	4.50
Imports of Goods and Services	3.30	16.30	8.50	7.00
GDP	3.30	4.80	3.50	3.75
Total Domestic Demand	0.80	7.60	5.00	3.75
Memorandum Items				
Consumer Prices	19.30	11.70	9.75	7.50
Unemployment Rate	9.00	8.70	8.75	8.50

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 120.

1988 Outlook:

The contractionary monetary policy of 1986 to slow the growth in the money supply will continue for 1988 which is expected to drop inflation level for 1988 to 7.5 percent. These developments will cause domestic demand to drop a little in 1988 therefore, GDP growth will be moderate at 2.75 percent. The depreciation of the Escudo of 1987 (.5 percent monthly for the first six months of 1987) will reduce imports for 1988 while exports are expected to remain constant.

Major 1988 Occurrences:

On July 19 1987, Mr. Cavaco Silva's social democrat-government was returned to power, this government's intentions are:

a. Privatization of new industries

b. Breakup of the communist collectives in the southeast of Portugal. The social democratic party has control of just over 50 percent of the parliament and the support of the Portuguese population. This government is expected to store confidence in the economy and encourage the agricultural industry (OECD Economic Outlook, 1987).

12. SPAIN

Domestic demand growth of 5.8 percent led fixed capital investment to grow by 12 percent in 1986. Unemployment rate dropped by nearly one-half of one percent. Since Spain joined the EEC in January 1986, imports have grown by large amounts while exports have declined. The deterioration of the trade balance was partially contributed to the decline in oil prices in 1986. GDP grew by 3 percent and expected to stay at that level by the end of 1987. Spain has been experiencing a surplus in money transfers because of the fast-growing tourism that is allowing repayment of advanced governments debts (OECD Economic Outlook, 1987). In 1987, Spain is expecting to reduce its deficit as a percentage of GDP. During the first four months of 1987, the Central bank of Spain tightened monetary growth which will help inflation to drop to nearly 6 percent by year's end and to about 5 percent in 1988 **(Table XIX)**.

Table XIX. SPAIN
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	3.90	12.00	9.50	5.00
Exports of Goods and Services	2.90	1.00	4.50	5.50
Imports of Goods and Services	5.40	16.10	14.00	7.25
GDP	2.20	3.00	3.00	2.75
Total Domestic Demand	2.70	5.80	4.75	3.25
Memorandum Items				
Consumer Prices	8.30	8.90	5.75	4.75
Unemployment Rate	21.90	21.50	21.00	20.50

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 121.

1988 outlook:

Assuming exchange rates remain stable at its present level of 1987, exports will be expected to increase by 5.5 percent while imports will decline by nearly 7 percent. The growth of 1987 will have a half percentage point in expected to drop in the unemployment level of 1988.

13. SWEDEN

The 1986 total domestic demand growth slowed in 1986; the low (1.8 percent) increase from the previous year was caused mainly by the decline in business fixed investments. Net imports of goods and services along with the decline in total domestic demand caused GDP to grow by only 1.3 percent from the previous year. While unemployment rate remained stable at a low level, consumer prices declined to 4.7 percent in 1986 as compared to 7.3 percent in 1985 as a result of that year's decline in oil prices. With higher

real disposable income and lower nominal interest rate, total domestic demand will rise in 1987 causing GDP to increase slightly; however, the margin of the trade deficit of goods and services is increasing in 1987 **(Table XX)**.

Table XX. SWEDEN
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	6.30	-0.80	2.75	2.00
Exports of Goods and Services	2.30	2.10	2.00	2.50
Imports of Goods and Services	7.70	3.60	3.75	3.25
GDP	2.20	1.30	1.75	1.50
Total Domestic Demand	3.90	1.80	2.50	1.75
Memorandum Items				
Consumer Prices	7.30	4.70	4.50	4.25
Unemployment Rate	2.30	2.20	2.25	2.50

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 122.

1988 Outlook:

The widening trade deficit of 1987 will cause total domestic demand to decline for 1988 which will cause the unemployment rate to increase slightly and GDP to decline.

1988 Major Occurrences:

Tight fiscal policy will continue which means that there will be stimulation in the economy even though it is accompanied by less government spending (OECD Economic Outlook, 1987).

14. SWITZERLAND

Total domestic demand increased by 5.1 percent, gross fixed capital investment increased to 7.4 percent in 1986.

While imports of goods and services increased to 7.6 percent, exports decreased to 3 percent which held GDP growth to only 2.8 percent in 1986. Unemployment rate dropped slightly because of the sharp increase in domestic demand. Growth in real wages that existed in 1986 is expected to slow down for 1987 and continue to 1988 which will help inflation to pick up a little since nominal wages will be increasing **(Table XXI)**.

Table XXI. SWITZERLAND
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	5.70	7.40	4.75	3.25
Exports of Goods and Services	8.30	3.00	2.00	3.50
Imports of Goods and Services	5.00	7.60	4.00	4.00
GDP	4.00	2.80	1.75	2.00
Total Domestic Demand	2.60	5.10	2.75	2.25
Memorandum Items				
Consumer Prices	3.60	0.40	1.50	2.00
Unemployment Rate	1.00	0.80	1.00	1.00

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 123.

1988 Outlook:

Total domestic demand growth is expected to decelerate for 1988 with no major effect on employment, because exports are expected to increase slightly. The appreciation of the Swiss Franc will stop and stay at its present level throughout 1987 since the U.S. dollar will stop depreciating against major foreign currencies due to the internal attempts of the

Federal Reserve to save the dollar value (through increased U.S. discount rates) (OECD Economic Outlook, 1987).

15. UNITED KINGDOM

The United Kingdom is enjoying economic growth with output being 3.0 percent in 1986 and nearly 3.25 for 1987. Total domestic demand is growing, causing fixed investments to grow and the unemployment rate to decline. With increasing output and with the 1986 depreciation of the Sterling, exports are expected to grow rapidly in 1987. While consumer prices are expected to rise gradually throughout 1986-88, this level of inflation is still considered to be low **(Table XXII)**.

Table XXII. UNITED KINGDOM
Demand, Output, and Prices
Percentage Changes

	1985	1986	1987	1988
Gross Fixed Capital Formation	1.80	0.60	2.75	3.50
Exports of Goods and Services	5.80	3.00	4.50	1.50
Imports of Goods and Services	3.10	5.80	4.50	4.50
GDP	3.50	2.70	3.25	2.25
Total Domestic Demand	2.80	3.20	3.25	3.00
Memorandum Items				
Consumer Prices	5.40	3.70	4.00	4.25
Unemployment Rate	11.70	11.80	11.25	10.75

Source: OECD, Economics and Statistics Department, Economic Outlook, Volume 41, June 1987, page 89.

1988 Outlook:

Gradual deceleration in monetary growth will continue in 1988 as it began in 1987 (OECD Economic Outlook, 1987).

Domestic demand is expected to remain strong although less than its level of 1987. Exports will slowdown in 1988 because of the increase in unit labor costs in 1986-87 will help consumer prices to rise slightly.

VI. Summary, Conclusion, and Implications

A. Summary and Conclusion

The 1980's started with sluggish growth in the U.S., Japan, and Europe, accompanied by relatively high unemployment rates and a strong U.S. dollar. While the United States and Japan managed to improve output and reduce their unemployment rates, Europe improved output and significantly increased its unemployment rate. The European unemployment rate has exhibited two different patterns in the 1980's:

Prior to 1986, the rise in Europe's unemployment rate can best be explained by trends in employee productivity, real wage "rigidities", unionized wage-setting, and structural changes instead of the "traditional" Classical and Keynesian theories.

Post 1986, the European unemployment and wages are returning to the principles as described by the Phillips Curve - which "relates the rate of change of wages to the level of unemployment **(Figure III)**. The lower the unemployment rate, the more rapid the rate of wage increase" (Dornbusch and Fischer, 1984).

The European macroeconomic conditions are best described in Layard and Nockell as: "...Mrs. Thatcher has raised unemployment and inequality, and reduced inflation...Benefits have certainly been, but there have also been cost" (Layard and Nockell, 1989).

B. Implications to U.S. Multinational Corporations

Although the European economy has become stable in the late 1980's and the unemployment rate has been declining gradually, the European economies are on the verge of experiencing tough economic times in the 1990's, which may cause a worldwide economic slowdown. Some of the implications are:

1) German unification - East and West Germany have merged their economies on July 1, 1990. The West German government purchased the East German near worthless currency and increased its labor force by one third of its current level. The cost burden has been placed on the West German taxpayer to pay for the East German currency, and for the East German worker's training and education. The real benefit to the "new" Germany will only appear after the East German standard of living has risen high enough for East Germans to be able to purchase West German goods and give back to the economy that has been the main supporter. A slowdown in the West German economy translates into a slowdown in U.S. multinational corporation revenues since the German economy is a major part of the European market. (Economist, July 1990)

2) Europe 1992 - The twelve-member European Community states will accelerate attempts to unify their economies by the end of 1992. Belgium, Denmark, France, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, United

Kingdom, and West Germany are attempting to unify their economies by eliminating barriers that negatively affect their trading positions in world markets. Such modification include the reduction of tariffs, and possible monetary unification.

The European Community is the U.S.'s greatest bilateral trade partner. The community market size is 323 million consumers, that is significantly bigger than the Japanese market, has an output of $ 4.5 trillion. The developments taking place in the EEC must be of special interest to U.S. multinational corporations because "such a 'Fortress Europe' could leave American business on the outside looking in" unless they are strategically positioned in the European market (Thompson, 1989).

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